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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Postretirement Benefits Other Than Pensions"	)	CC Docket No. 92-101
	)	
U S WEST Communications, Inc. Tariff F.C.C. Nos. 1 and 4	)	Transmittal No. 246

REBUTTAL

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SUMMARY

In this Rebuttal, U S WEST Communications, Inc. ("U S WEST") again demonstrates that the costs associated with implementing SFAS-106 should be given exogenous treatment under the Federal Communications Commission's ("Commission") price cap rules.

Contrary to the assertions of opponents, exogenous treatment of SFAS-106 costs will not undercut price cap regulation. SFAS-106 is a GAAP change entirely beyond U S WEST's control which U S WEST is required to implement on or before January 1, 1993. Only a small portion of the incremental costs of implementing SFAS-106 will be reflected in the GNP-PI, the inflation measure in the price cap formula. U S WEST has removed all such "double-counting" effects, no matter how small, from its request for exogenous treatment.

U S WEST believes that changes such as those required by SFAS-106 are exactly the type of changes which the Commission anticipated when it adopted its price cap provisions on exogenous cost treatment. As such, the Commission should dismiss arguments that exogenous treatment of SFAS-106 costs is incompatible with price cap regulation and allow Transmittal No. 246 to take effect as scheduled.

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REBUTTAL

U S WEST Communications, Inc. ("U S WEST"),[1] through counsel and pursuant to the Federal Communications Commission's ("Commission") Order of Investigation and Suspension,[2] hereby files its rebuttal to Oppositions to U S WEST's Direct Case on Transmittal No. 246.[3] Transmittal No. 246 revised U S WEST's rates and price cap indices to reflect the adoption of Statement of Financial Accounting Standards No. 106 ("SFAS-106").[4]

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[1]U S WEST is a common carrier provider of exchange access and exchange telecommunications services.

[2]Order of Investigation and Suspension, 7 FCC Rcd. 2724 (1992) ("Investigation Order"). See also Order, DA 92-921, rel. July 10, 1992, which afforded all interested parties until July 31, 1992 to file reply comments in this proceeding.

[3]Oppositions were filed by the American Telephone and Telegraph Company ("AT&T"), MCI Telecommunications Corporation ("MCI"), Ad Hoc Telecommunications Users Committee ("Ad Hoc") and the International Communications Association ("ICA") on July 1, 1992.

[4]See U S WEST Communications Tariff F.C.C. Nos. 1 and 4, Transmittal No. 246, filed Apr. 3, 1992.

I. INTRODUCTION

A. Background

In Transmittal No. 246, U S WEST proposed that the costs associated with implementing SFAS-106 be treated as exogenous costs under the Commission's LEC Price Cap Order.[5] The Commission suspended Transmittal No. 246 and designated issues for investigation in its Investigation Order.[6] In its Direct Case, U S WEST responded to the Commission's inquiries and demonstrated that Other Postretirement Employee Benefit ("OPEB") costs associated with implementing SFAS-106[7] should be treated as

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[5]See Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786 (1990) ("LEC Price Cap Order"), on recon., 6 FCC Rcd. 2637 (1991) ("LEC Price Cap Recon. Order"), appeals pending sub nom. Nat'l Rural Telecom Ass'n v. F.C.C., No. 91-1300 (D.C. Cir. pet. for rev. filed June 26, 1991).

[6]Investigation Order, 7 FCC Rcd. at 2725 ¶ 8.

[7]SFAS-106 requires that business use an accrual method of accounting for postemployment benefit costs rather than using a "pay-as-you-go" approach to account for these costs, as U S WEST and other companies have done in the past. SFAS-106 also requires that companies recognize the Transition Benefit Obligation ("TBO") -- the liability associated with benefits earned by both retirees and current employees prior to the adoption of SFAS-106. SFAS-106 allows companies to recognize the TBO by expensing it at the time of adoption or amortizing it over a period of no more than 20 years. On December 26, 1991, the Commission issued an Order authorizing all carriers to adopt SFAS-106 on or before January 1, 1993, using the amortization method of recognizing the TBO. See Southwestern Bell, GTE Service Corporation - Notification of Intent to Adopt Statement of Financial Accounting Standards No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions, 6 FCC Rcd. 7560 (1991) ("SFAS-106 Order"). Section 32.16(a) of the Commission's rules also requires that carriers adopt accounting standards prescribed by the Financial Accounting Standards Board ("FASB") such as SFAS-106. See 47 C.F.R. § 32.16(a).

exogenous costs under price cap regulation.[8] In Transmittal No. 246 and its Direct Case, U S WEST demonstrated that only a small portion of the incremental costs of implementing SFAS-106 would be reflected in the Gross National Product Price Index ("GNP-PI"), the inflation measure in the price cap formula.[9] U S WEST also pointed out that SFAS-106 is a GAAP change entirely beyond its control, and that under Commission rules U S WEST is required to implement SFAS-106 on or before January 1, 1993.

B. SFAS-106 Requires Accrual Accounting

SFAS-106 is different from most accounting changes issued by the FASB in that it involves a change from cash-basis accounting to accrual-basis accounting. Most accounting pronouncements deal with disclosure issues and the selection of the best method of accrual accounting.[10] The changes contained in SFAS-106 are much

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[8]See U S WEST Direct Case, filed herein June 1, 1992 at 5.

[9]The primary factor in determining if a Generally Accepted Accounting Principles ("GAAP") change is eligible for exogenous treatment under price cap regulation is whether the costs of a particular change will be reflected in the GNP-PI. "If a GAAP change is universal enough to be reflected in the inflation measure, exogenous cost treatment would result in double counting within the context of the PCI." LEC Price Cap Recon. Order, 6 FCC Rcd. at 2665 ¶ 63. Conversely, if a GAAP change is not reflected in the GNP-PI or where only a small portion of the costs associated with the change is reflected in the GNP-PI -- as is the case with SFAS-106 -- exogenous treatment is appropriate.

[10]This was the case with SFAS-87 -- Accounting for Pensions, which became effective in 1987. Prior to SFAS-87, American industry followed accrual methods in accounting for their pension costs. Cash-basis accounting was not an acceptable method of accounting for defined benefit pension plans even prior to SFAS-87. SFAS-87 reviewed many different actuarial methodologies in (continued...)

more significant. In SFAS-106, the FASB concluded that cash-basis accounting for OPEB results in insufficient cost being assigned to the period when employees perform service. SFAS-106 remedies this problem by requiring companies to accrue for OPEB costs in the periods when they are incurred.

As previously shown in U S WEST's Direct Case, as of January 1, 1993, U S WEST will have an actual projected benefit obligation (i.e., APBO) of $2.8 billion. This entire amount represents the cost of employee service prior to 1993. Of this amount, $1.5 billion relates to former employees who have retired from U S WEST. Over 85% of this $2.8 billion liability was incurred during the period prior to price cap regulation when the Commission employed rate of return regulation to establish rates. Only a small portion of these costs has ever been reflected in access rates.[11]

If the embedded OPEB costs contained in U S WEST's initial price cap rates equalled current service cost under SFAS-106[12]

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[10](...continued) use to develop an accrual-based liability and selected a method that would provide a consistent accrual methodology across American industry. Although this change did cause the liability of some companies to increase or decrease, it did not represent a fundamental change from cash-basis accounting to accrual-basis accounting.

[11]U S WEST's initial price cap rates contained $43 million of pay-as-you-go health care costs for retired employees and $15 million of payments to U S WEST's Voluntary Employee Beneficiary Association trust funds.

[12]Service cost is the actuarial present value of the expected benefit obligation allocated to a period of employee service during the attribution period.

and no other costs existed (i.e., no TBO), there would be no need for exogenous treatment. Under such a scenario, it would be U S WEST's responsibility to manage these costs and costs associated with future employee service within the parameters of the price cap formula. But this is not the case -- the TBO does exist. At the commencement of price cap regulation, U S WEST's OPEB costs embedded in rates covered service cost and a portion of the TBO-related costs.[13] U S WEST's initial price cap rates did not reflect all of the costs associated with its TBO, a $2.5 billion unfunded liability that SFAS-106 requires U S WEST to recognize on its books of account as of January 1, 1993.

Thus, if SFAS-106 had been adopted prior to the introduction of price cap regulation on January 1, 1991, there would be no need for exogenous treatment and SFAS-106 costs would be properly reflected in U S WEST's initial price cap rates. U S WEST and other price cap local exchange carriers ("LEC") should not be penalized because SFAS-106's accrual-based accounting requirements for OPEB costs do not go into effect until January 1, 1993. As such, the proper way to handle this accounting change from a cash basis to an accrual approach in accordance with the Commission's price cap rules is to treat the costs associated with previously unrecognized liabilities as exogenous costs. U S WEST believes that this is exactly the type of situation which the Commission anticipated when it adopted its

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[13]Separated interstate costs for 1993 are expected to be: service cost - $14.5 million; TBO amortization - $30.1 million; and interest on the TBO - $54.6 million.

price cap provisions on exogenous cost treatment.

C. Oppositions

Only four parties, AT&T, MCI, Ad Hoc, and ICA, filed oppositions to U S WEST's Direct Case challenging the exogenous treatment of SFAS-106 costs. While these oppositions raise numerous issues, the issues fall into four general categories:

1. Claims that SFAS-106 costs do not qualify for exogenous treatment under the Commission's price cap rules.[14]

2. Claims that U S WEST and other LECs have double-counted in calculating the portion of SFAS-106 costs which should receive exogenous treatment. These claims are based on the assertion that both the GNP-PI and the rate of return used to establish price cap rates either currently reflect or will reflect SFAS-106 costs in the future.[15]

3. Claims that the Godwins model suffers from other deficiencies in addition to double-counting.[16]

4. Claims that U S WEST and other LECs have used inappropriate actuarial factors in developing SFAS-106 costs.[17]

As the following comments demonstrate, opponents' claims are without merit. U S WEST has met its burden of proof of demonstrating that SFAS-106 costs are beyond its control and that no double-counting would result from exogenous treatment.

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[14]See Opposition of AT&T at 6-8. See also Opposition of MCI at 5-11; Opposition of Ad Hoc at 5-19.

[15]See Opposition of AT&T at 6-14. See also Opposition of MCI at 11-17; Opposition of Ad Hoc at 12-13.

[16]See Opposition of Ad Hoc at 19-22. See also Opposition of MCI at 24-26; Opposition of AT&T at 8-12.

[17]See Opposition of AT&T at 25-29. See also Opposition of MCI at 27-29; Opposition of Ad Hoc at 13.

Therefore, the Commission should terminate its tariff investigation and allow Transmittal No. 246 to take effect as scheduled.

II. EXOGENOUS TREATMENT OF SFAS-106 COSTS IS CONSISTENT WITH PRICE CAP REGULATION

For one reason or another, opponents claim that the costs associated with implementing SFAS-106 should not be treated as exogenous costs under price cap regulation.[18] In order for a GAAP change such as SFAS-106 to qualify for exogenous treatment, the Commission must find that the change: is compatible with its regulatory accounting needs;[19] is beyond the carrier's control;[20] has been approved by FASB and is in effect;[21] and is not reflected in the GNP-PI.[22]

AT&T concedes that all of the above criteria have been satisfied with the exception of demonstrating that SFAS-106 costs will not be reflected in the GNP-PI.[23] In the sections which

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[18]"Exogenous costs are in general those costs that are triggered by administrative, legislative or judicial action beyond the control of the carriers. . . . [T]hese are costs that should result in an adjustment to the cap in order to ensure that the price cap formula does not lead to unreasonably high or unreasonably low rates." LEC Price Cap Order, 5 FCC Rcd. at 6807 ¶ 166.

[19]Id. at ¶ 168.

[20]Id. at ¶¶ 166, 168.

[21]LEC Price Cap Recon. Order, 6 FCC Rcd. at 2663 ¶ 59.

[22]Id. at 2663-65 ¶¶ 59-63; Investigation Order, 7 FCC Rcd. at 2725 ¶ 6.

[23]Opposition of AT&T at 6.

follow, U S WEST rebuts this last contention and demonstrates that there is no double-counting. In opposing exogenous treatment, MCI offers similar double-counting arguments and also contends that SFAS-106 costs are within the control of the carriers.[24] MCI argues that "[t]he provision of OPEBs is not mandated, but rather the accounting treatment of these costs is promulgated by FASB."[25] This is a distinction without a difference. The fact is that SFAS-106 costs do exist and U S WEST is required to recognize them under Section 32.16(a) of the Commission's rules.[26] Assuming that there is no double-counting and that the GAAP change associated with SFAS-106 is compatible with the Commission's regulatory accounting needs, as appears to be the case,[27] this change should be given exogenous treatment as are other changes in LEC costs caused by Uniform System of Accounts ("USOA") changes.[28]

MCI also argues that it would be inappropriate to give exogenous treatment to one portion of the compensation package.[29] MCI incorrectly implies that U S WEST and other LECs have the

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[24]Opposition of MCI at 8.

[25]Id (emphasis in original).

[26]47 C.F.R. § 32.16(a).

[27]The Commission authorized all carriers to adopt SFAS-106 on or before January 1, 1993 and required them to use the amortization method for recognizing the TBO. SFAS-106 Order, 6 FCC Rcd. 7560 ¶ 5.

[28]LEC Price Cap Order, 5 FCC Rcd. at 6807 ¶ 168.

[29]Opposition of MCI at 6.

ability to change OPEB costs at will. This is not the case. MCI ignores the fact that a large portion of SFAS-106 costs are associated with the TBO, a liability based on past commitments. SFAS-106 also affects service costs for any given level of benefits. Thus, while there is a grain of truth in MCI's assertion, it is a gross over-simplification of the impact of SFAS-106 on OPEB costs. Ad Hoc and ICA basically raise the same arguments as AT&T and MCI. In order to avoid being repetitive, U S WEST will not individually rebut the arguments of Ad Hoc and ICA.

In summary, U S WEST believes that SFAS-106 costs should be accorded exogenous treatment. Exogenous treatment of SFAS-106 costs will not undercut price cap regulation. In fact, the Commission specifically made provisions for exogenous cost treatment in its price cap plan to accommodate changes such as SFAS-106.[30] U S WEST has fully met its burden of proof by demonstrating that no double-counting occurs. Exogenous treatment has not been requested for any SFAS-106 costs which might be reflected in the GNP-PI. As such, the Commission should dismiss arguments that exogenous treatment of SFAS-106 costs is incompatible with price cap regulation and allow Transmittal No. 246 to take effect as scheduled.

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[30] LEC Price Cap Order, 5 FCC Rcd. at 6807 ¶ 166.

III. EXOGENOUS TREATMENT OF SFAS-106 COSTS WILL NOT RESULT IN DOUBLE-COUNTING

A. GNP-PI

Opponents claim that double-counting will occur if SFAS-106 costs are treated exogenously because the GNP-PI will rise as firms with OPEB liabilities raise their prices and because SFAS-106 costs include estimates of future medical cost inflation.[31] Godwins fully addresses this and other assertions with respect to double-counting and opponents' proposed solutions in its Supplemental Report, which is contained in the Attachment hereto.[32] Godwins points out that the primary purpose of its original study was to ensure that there was no double-counting.[33] Both Godwins' Study and its Supplemental Report demonstrate that exogenous treatment of SFAS-106 costs will not lead to double-counting and, as such, there is no merit to opponents' claims.

B. Rate of Return

A more "creative" double-counting argument is contained in the ETI Study and MCI's Opposition and its accompanying Affidavit

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[31] Opposition of AT&T at 7; Opposition of MCI at 2; Opposition of Ad Hoc at 13.

[32] Id. See also Godwins Analysis of Impact of SFAS 106 Costs on GNP-PI, Feb., 1992.

[33] See Godwins Analysis of Impact of SFAS 106 Costs on GNP-PI, Supplemental Report: Responses to Objections Raised Regarding Original Study, July, 1992, at 1-7.

of Professor Allan Drazen.[34] MCI asserts that exogenous treatment of SFAS-106 costs should be rejected because "some significant portion of SFAS-106 costs has already been captured by the cost of equity calculation within the rate of return proceeding[.]"[35] MCI claims that LECs must first quantify this amount and eliminate it from their estimates of SFAS-106 costs, if double-counting is to be avoided as is required by the price cap rules.[36]

While MCI's argument may appear to have some superficial merit, it self-destructs on closer examination. First, the Commission has no such requirement to eliminate "rate of return double-counting" in order to qualify for exogenous treatment under price cap regulation. Second, the 11.25% return level that was used to establish initial price cap rates was not the result of any market forces. It was the return selected by the Commission from a wide range of estimates using a variety of methodologies. It requires quite a leap of faith to conclude that OPEB costs are reflected in the authorized rate of return and, therefore, in initial price cap rates. Third, even if one accepts this premise, it ignores offsetting factors such as the downward impact of OPEB costs on carrier earnings and dividends.

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[34]See Analysis of SFAS 106 Effects Under Price Caps, A Test Case for LEC Price Cap Regulation by the FCC, ("ETI Study") attached to Ad Hoc Opposition and Opposition of MCI at 12 and Appendix A.

[35]Opposition of MCI at 12.

[36]Id.

Lastly, the inverse of MCI's rate of return argument would imply that LECs' Price Cap Indexes ("PCI") should be adjusted upward to reflect the exogenous treatment of inside wire, Reserve Deficiency Amortizations ("RDA"), Dial Equipment Minutes ("DEM") and Basic Allocator Factor ("BAF"). While this assertion may appear to be somewhat preposterous, it is based on the same assumptions which underlie MCI's double-counting argument.

As the above discussion demonstrates,[37] no purpose would be served by delving back into a past rate of return represcription to determine what information was reflected in the rate of return finally selected by the Commission. The Commission's price cap rules and associated orders do not require such a _post hoc_ analysis in order to qualify for exogenous cost treatment. The Commission has already placed a significant burden of proof on LECs to qualify for exogenous cost treatment. No purpose would be served by placing an impossible burden of proof on LECs, as opponents propose -- other than to undermine the foundations of price cap regulation.

IV. THE GODWINS STUDY PROVIDES A REASONABLE APPROXIMATION OF THE IMPACT OF SFAS-106 ON THE GNP-PI

Opponents assert that the Godwins Study and associated model are flawed and are not representative of the impact of SFAS-106 costs on the GNP-PI. According to opponents, these deficiencies

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[37] _See_ Response of United States Telephone Association ("USTA") filed herein today for a more detailed rebuttal of MCI's rate of return arguments.

range from incorrect model specifications to inappropriate estimates of model inputs.[38] These attacks on the validity of the Godwins Study are not unexpected given the importance of this Study to LEC efforts in fulfilling their burden of proof.

As Godwins demonstrates in the attached Supplemental Report,[39] its Study provides a reasonable approach to estimating the impact of SFAS-106 costs on the GNP-PI. In its Supplemental Report, Godwins responds directly to opponents' attacks on the efficacy of its model. U S WEST will not repeat Godwins' responses herein -- other than to say that opponents have presented no evidence which discredits Godwins' model or invalidates the subsequent model outputs.

V. U S WEST'S ACTUARIAL ASSUMPTIONS PROVIDE A REALISTIC BASIS FOR CALCULATING SFAS-106 COSTS

AT&T expresses a concern that, if the Commission allows exogenous treatment of SFAS-106 costs, LECs might receive a windfall if actual OPEB costs turn out to be less than the

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[38] For example, Ad Hoc asserts "Godwins employed the wrong kind of model to evaluate the cost effects on LECs of the implementation of SFAS-106." Opposition of Ad Hoc at 20. AT&T claims the Godwins Study is seriously flawed because "the results of the Godwins Study depend on the calculation that the adoption of SFAS-106 will increase labor costs by 3% for firms incurring OPEB expenses." Opposition of AT&T at 9. MCI also finds fault with the Godwins Study because it "uses data from only one insurance company to arrive at the cost of medical claims for the calculation of the nationwide Benefit Level Indicator." Opposition of MCI at 26.

[39] _See_ Attachment hereto.

amounts requested in the instant LEC tariff filings.[40] AT&T proposes that the Commission remedy this problem by requiring price cap LECs to recalculate their OPEB accruals using a common set of assumptions.[41] AT&T suggests that medical expense costs per employee be capped at the level projected as of January 1, 1993 for active employees,[42] and that SFAS-106 accruals be recalculated using the following parameters:[43]

	AT&T Proposal	
Discount Rate	9%	
Rate of Return on Plan Assets	9%	
Health Care Trend Rate (includes inflation)	10%	in 1991, decreasing by 0.4% annually to 4% in 2006

Clearly, AT&T's proposals accomplish its purpose -- to minimize both ongoing service cost and TBO costs. However, AT&T's proposals do not represent a realistic estimate of either LEC OPEB expense or the interaction of the individual parameters.[44] While one may desire a high discount rate and high

[40]Opposition of AT&T at 24.

[41]Id. at 25-29.

[42]Id. at 26.

[43]Id. at 28. Under the guise of demonstrating the "reasonability" of these parameters, AT&T points out that every one of these parameters was used by an individual LEC in calculating its OPEB liabilities.

[44]It is interesting to note that AT&T did not find these same assumptions on the discount rate and rate of return on plan assets to be appropriate for use in its own pension plan. In that case, AT&T used a discount rate of 8.0% and a rate of return on plan assets of 8.6%. See AT&T 1991 Annual Report at 35-36.

return on plan assets, and a low rate of health care inflation, these are not realistic expectations over any period of time. If returns and interest rates are high, inflation will also be high.[45] Thus, while AT&T would have the Commission believe that it can select the individual parameter values in isolation, this is not the case. The values of parameters must make sense both individually and as a group -- AT&T's do not.

While one can quibble with any one of U S WEST's actuarial assumptions, U S WEST believes that, as a group, these assumptions represent a very conservative basis for calculating SFAS-106 costs. U S WEST did not just pick these assumptions out of "thin air." For example, U S WEST's health care trend assumption is based on actual U S WEST retiree health care cost trends. U S WEST did not "game" the numbers, as AT&T implies, to maximize the amount of OPEB costs eligible for exogenous treatment. No purpose would be served by adopting AT&T's proposed parameters -- they do not, as a group, represent realistic expectations nor will their use lead to reasonable estimates of OPEB costs for any price cap LEC.

U S WEST also believes that it would be inappropriate to use the same set of parameters for all price cap LECs. Health care

[45] Investment returns and interest rates embody investors' expectations of inflation during the period of time which corresponds to the maturity of the investment. Many economists believe that the "real" long-term interest rate of a risk free investment is approximately 3.0%. This means that the "nominal" interest rate is 3.0% plus the inflation rate. Clearly, the spread between AT&T's proposed parameters is significantly greater than 3.0%.

costs, benefit provisions and retiree populations among price cap LECs.[46] Also, SFAS-106, in effect, requires the use of a different rate of return on plan assets. SFAS-106 states that the expected rate of return should "reflect the average rate of

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[46]For example, AT&T's proposal that all LECs should use identical medical trend rates does not reasonably represent the variability in medical care costs that exists across the United States. The following table shows the wide range of increases in average hospital stay costs for the period 1986-1991 for several states:

CUMULATIVE INCREASE IN COSTS PER HOSPITAL STAY

State	Percentage Increase
California	102%
Colorado	71%
Florida	105%
Illinois	82%
New York	51%
Pennsylvania	53%
Washington	169%

Source: Annual Actuarial Cost Study, Mutual of Omaha Insurance Company.

Similarly, the following table shows the dramatic variation in the increase of physician office charges over the period 1989-1991 for several cities:

CUMULATIVE INCREASE IN PHYSICIAN OFFICE VISIT CHARGES

City	Percentage Increase
Atlanta	2%
Denver	12%
Los Angeles	3%
New York	15%
Seattle	23%

Source: Annual Actuarial Cost Study, Mutual of Omaha Insurance Company.

Thus, rather than using identical rates for all price cap LECs, medical trend rates should represent the current best estimate of future medical costs increases for each LEC.

earnings expected on the existing assets" and that this return should take into consideration "the returns being earned on the plan assets[.]"[47]

An even more "far fetched" proposal by AT&T is that medical cost expense for active employees be capped at the level projected as of January 1, 1993. Use of such an assumption in calculating SFAS-106 costs would only distort the results. Even if the Commission chooses to limit the portion of OPEB costs which are allowed exogenous treatment, no purpose would be served by starting out with a service cost estimate which is divorced from reality. It would be difficult, if not impossible, for the Commission to make an informed decision on exogenous treatment if it adopts AT&T's proposal on capping medical costs for active employees. As such, the Commission should reject AT&T's proposal as lacking in merit.

In closing, U S WEST notes that much, if not all, of the risk which AT&T refers to in its discussion of parameters will be eliminated by U S WEST's proposed "true-up" provision which is discussed in the following section.

VI. ANY DEFICIENCIES IN U S WEST'S ESTIMATES OF THE IMPACT OF SFAS-106 WILL BE REMEDIED BY AN ANNUAL TRUE-UP

Although a true-up provision would not normally be required for an exogenous cost, U S WEST believes that SFAS-106 costs should be trued-up annually because they differ significantly

[47]SFAS-106 at ¶ 32.

from other exogenous costs. While most exogenous cost adjustments are easily quantifiable and occur over a relatively short period of time, OPEB costs are incurred over an employee's lifetime and are subject to the health of the employee and the cost of medical care. A true-up provision will serve the public interest and ensure that significant changes in actuarial assumptions will not result in a windfall to LECs.

However, U S WEST does not believe that a true-up of the entire OPEB expense would be appropriate. Only those costs associated with the TBO as of January 1, 1993 should be trued-up -- that is, the amortization of the TBO and associated interest cost and investment return. Costs associated with future service cost should not be the subject of a true-up but should be treated in the same manner as any other cost under price cap regulation. Such an approach would ensure that neither the public nor U S WEST would be harmed by changes in actuarial assumptions which impact past obligations (i.e., the TBO) while ensuring that U S WEST has an incentive to minimize current costs (i.e., service cost).

U S WEST's proposed true-up provisions are entirely consistent with SFAS-106 -- which requires a true-up of OPEB costs when assumptions and health care plan provisions change.[48] SFAS-106's provisions will result in automatic true-ups to the TBO which will be reflected in exogenous adjustments to annual

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[48]SFAS-106 at ¶ 50-62.

access filings if the Commission adopts U S WEST's proposal.[49]

VII. CONCLUSION

As the foregoing demonstrates, SFAS-106 costs should be given exogenous treatment under the Commission's price cap rules. U S WEST has met its burden of proof of showing that cost changes associated with implementing SFAS-106 are beyond its control and that all "double-counting" effects have been removed from its request for exogenous treatment. Therefore, U S WEST requests that the Commission terminate its investigation and allow Transmittal No. 246 to go into effect as scheduled.

Respectfully submitted,

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July 31, 1992

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[49]For example, under SFAS-106, any cost reductions flowing from health care plan amendments which reduce a company's OPEB liability must first be applied to reducing unrecognized prior service costs and the TBO. Any such reductions in the TBO will result in a lower amortization and lower exogenous costs under U S WEST's true-up proposal.

ATTACHMENT

UNITED STATES TELEPHONE ASSOCIATION

Analysis of Impact of SFAS 106 Costs on GNP-PI

Supplemental Report: Responses to Objections Raised Regarding Original Study

Godwins

July, 1992

INTRODUCTION

Earlier this year, Godwins submitted a report to the United States Telephone Association (USTA) analyzing the impact of SFAS 106 on the GNP-PI, and, in particular, the extent to which the GNP-PI will reflect the increase in costs experienced by the Price Cap LECs as a result of adopting the new accounting standard. This report was placed on the record with the FCC in Bell Atlantic's Tariff Transmittal filed on February 28, 1992 (Transmittal No. 497) and was also included in U.S.West's Tariff Transmittal filed on April 3, 1992 (Transmittal No. 246).

In their filings with the FCC, several organizations took exception to the findings of that report. In particular, AT&T, MCI and the Ad Hoc Telecommunications Users Committee raised several objections with regard to various aspects of the study. The USTA has asked Godwins to provide a detailed response to each of those objections.

The purpose of this Supplemental Report is to provide the USTA with those responses. We have organized our responses into three sections, corresponding to the three different types of objections raised.

While the objections raised were numerous, this material will demonstrate that none of the objections raised should cause the Commission to have any doubts regarding the soundness of the study, or the validity of the results.

Respectfully Submitted,

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